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IDENTIFICATION OF AREAS WHERE TECHNICAL COOPERATION IN SUPPORT OF POLICY DEVELOPMENT TO ENHANCE THE ROLE OF SMALL AND MEDIUM-SIZED ENTERPRISES COULD BE STRENGTHENED

Technical cooperation for policy development to enhance the role of small and medium-sized enterprises

Report by the UNCTAD secretariat

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Introduction

1. The Trade and Development Board, by its conclusions and decisions 415 (XL), established the Ad Hoc Working Group on the Role of Enterprises in Development. According to its terms of reference, the Ad Hoc Working Group should analyse the interrelationship between the development of a domestic entrepreneurial capacity, in particular for the development of small and medium-sized enterprises (SMEs), and the development process. Particular attention should be paid to the situation of the least developed countries. Particular topics identified for analysis should include: (i) the role of the State in creating an enabling environment for the promotion of entrepreneurship and the viable development of enterprises, with reference to the regulatory framework and incentives structures, human resources development, institution building and institutional support and the informal sector and its integration into the formal economy; (ii) export development and the role of SMEs, giving due attention to the possible advantages arising from the globalization process; (iii) interactions between the development of SMEs and of capital markets and banking systems, with reference to the generation of domestic savings and access to capital markets and other sources of financing; and (iv) identification of areas where technical cooperation in support of policy development to enhance the role of SMEs could be strengthened. The Ad Hoc Working Group should provide a forum for the exchange of experiences among member States so as to enable them to draw appropriate lessons for the formulation and implementation of policies at the national and international levels and for international economic cooperation.

2. This report has been prepared by the UNCTAD secretariat in order to facilitate consideration of topic (iv) mentioned above. This and topic (iii) will be considered at the second session of the Ad Hoc Working Group, scheduled to be held in Geneva from 3 to 7 July 1995. The first two topics were considered at the first session, held in Geneva from 3 to 7 April 1995. The report draws on, inter alia, studies of country experiences, including those submitted by Governments in response to a questionnaire prepared by the secretariat, from the following countries: Bolivia, China, Costa Rica, Ethiopia, Germany, Guinea, Indonesia, Kenya, Lithuania, Malaysia, Mauritius, Norway, Romania, Turkey and the United Kingdom.

3. The report raises and discusses policy issues which can be the subjects of useful cross-country exchanges of lessons learned and insights gained from national experiences, thus enabling policy elements to be derived for the formulation and implementation of policies at the national and international levels and "best practices" to be identified. Every effort has been made to build on the issues raised during the discussions at the first session on the topics of the enabling environment, and supportive policies, for SME and export development.

4. This report addresses areas of policy development to enhance the role of SMEs in the development process where technical cooperation may be strengthened. These include policy issues relating to (i) the creation of favourable framework and market conditions for SME development (including market failures, legal and regulatory constraints to market and enterprise development and institutional support for SME development); and (ii) networking and modernization of SMEs, as well as regional cooperation on SME development.

I. Creating favourable framework and market conditions

5. The State has a role to play in creating favourable framework and market conditions for the development of entrepreneurship and of enterprises, including SMEs. This implies the creation of a favourable macroeconomic framework for creating business confidence and reducing commercial, financial or investment risks associated with unexpected or sharp tax, interest rate or currency movements. Such conditions, together with appropriate Government support and financial markets regulations, will help to mobilize savings, develop financial institutions and markets and encourage investment, including foreign investment. Macroeconomic stability will also facilitate structural adjustment, including any industrial restructuring, designed to achieve more open markets and competitive enterprises. Thus, it is important that support programmes for SME development be properly designed and contribute to productive activities, so that they will be fiscally neutral and not undermine macroeconomic stability.

6. In addition, there is a need to create a sound policy and commercial framework for business development, in which markets can function efficiently, through the adoption of appropriate policies, including those relating to factor markets, the organization of the firm and support services, product markets and intellectual property, environment and standards. Such policies range from price deregulation, promoting greater flexibility and mobility in labour markets, development of financial markets and institutions, promoting competition to policies concerning human capital and infrastructure development. At the same time, the commercial framework -- including rules, laws and regulations governing the establishment and operations of companies, market entry and exit, as well as legal enforcement procedures -- needs to be clear, stable, predictable and effective.

7. These "framework conditions" -- macroeconomic stability and sound policy and commercial framework -- are especially vital for SME development, given their relative weakness vis-à-vis the stronger players. As a general rule, they should apply to all companies irrespective of size. However, because of the limited resources of SMEs, certain administrative rules (for example, for the registration of companies) may be simplified and made less time-consuming at little or no cost for small businesses, including micro-enterprises, in order to facilitate their registration and to encourage business start-ups. Furthermore, tax payment procedures may be simplified for small businesses by levying a small lump-sum tax without the need for the filing of tax returns or the keeping of detailed accounts - a system used, for example, in India.

8. Where the State succeeds in creating an environment that enables markets to function properly and efficiently, so that SMEs are not disadvantaged because of their size in relation to large enterprises, the best policy towards SMEs may be one of "maximum openness, minimum intervention". However, it is recognized that there may be instances where SMEs may need to be provided with particular assistance by the State. This need may arise where the cost of compliance, for example with environmental standards, or the increased cost of capital due to bad macroeconomic management is disproportionately higher for SMEs than for large enterprises. Furthermore, in Japan, subsidized loans by financial institutions created to cater to the needs of SMEs are provided in special cases, such as the modernization of production facilities, the relocation of plant or the conversion of business activities due to structural change. In any case,

the State, if it cannot be helpful, should at least refrain from making business activity difficult for SMEs by over-regulating or over-taxing them or by favouring large enterprises at their expense, which may in the process force them out of business.

9. However, where there are market distortions or failures, for example, where markets or inter-firm networks are controlled by dominant incumbents or where policies favouring large enterprises or the inefficient functioning of product, financial or other markets result in high cost, low quality or unavailability of essential inputs for SMEs, so that newcomers or SMEs cannot compete on a equal footing, the State may need to intervene to help the latter by taking measures to correct or eliminate market deficiencies. One such measure is a loan guarantee programme which can play an important role in changing the attitudes and practices of commercial banks, thereby increasing the access to credit for SMEs. In this context, consideration needs to be given to minimizing the risk of moral hazards. In some of the transitional economies, the restructuring of large enterprises into smaller, competitive and flexible firms has assumed a particular importance. However, such support for SMEs should be limited to creating a "level paying field", with the ultimate objective of fostering competitive enterprises in domestic and foreign markets.

10. Market failures are not just a matter of deficiencies in financial or other markets. The lack of communications infrastructure, including roads and telecommunications, causes other forms of market failure. Telecommunications is in fact the lifeline of business activity: markets cannot function without effective flows of information. It is hardly possible to conceive of networking, so essential for the development and modernization of SMEs, without adequate telecommunications. Subcontracting cannot be extended to SMEs in rural areas without adequate roads to such areas. Likewise, the lack of an educated labour force, or of entrerpreneurial and other skills needed for the business world, may also have a constraining effect on efficient market development.

11. Improvement of the legal and regulatory framework in which SMEs operate may also be necessary. This may involve removing or easing regulatory constraints, as in many developed and developing countries, or improving the overall legal framework governing business activities, as in many countries in transition, where the commercial framework is characterized not only by a lack of basic laws but also by a lack of consistency and stability in the existing laws. Regulatory constraints act on SMEs in different ways, for example by imposing barriers to entry to their operations (thus restricting competition) and by imposing a cost for business start-ups and development. On the other hand, inconsistencies and gaps in the overall legal framework, or lengthy or unpredictable legal enforcement procedures, can also act as impediments to SME development. A recent study stated that Government barriers to competition rather than labour market rigidities explain why recent employment creation has been lower in the European Union than in the United States and Japan (1). It has been noted that, in Italy, the absence of Government involvement in the development of SMEs (other than recent legislative measures to reduce restrictions on small firms), together with a policy of not actively levying taxes and payments of national insurance contributions on such firms, has created a considerable degree of independence and self-reliance among SMEs and fostered rather than hindered their development (2).

12. "Regulatory failure" may also help to explain why many micro-enterprises are associated with the informal sector and why the informal sector, rather than receding, is in fact growing in some

countries, such as Brazil. Understanding the reasons, and in particular the role played by the legal and regulatory framework, can help to shape policies that can assist micro-enterprises in the informal sector to grow or to graduate to the formal sector without destroying their important economic and social role, including the empowering of women in the process of development, or worse still forcing them into illegal activities, while recognizing that not all such enterprises wish to grow or to join the formal sector. Various kinds of measures may be taken for this purpose, including providing finance and physical facilities, as well as simplifying registration procedures and reducing the cost of administrative compliance. The creation of physical facilities for micro-enterprises in the informal sector can help to formalize their operations as well as provide them with stability and the type of environment which facilitates their access to credit and productive assets. In the final analysis, programmes to promote basic education and to raise skill levels may be the most effective way of helping them to be integrated with the formal sector. Investment in such programmes can bring long-term benefits in terms of strengthening entrepreneurship, increasing competition and enlarging tax receipts.

13. Many countries, recognizing the importance of the role played by SMEs in industrial and export development, particularly in the context of a globalizing and liberalizing world economy, have adopted proactive policies, together with institutional support, for the development of SMEs. Various Governments, as in Canada, France, Indonesia and United Kingdom, have even established Ministries or Departments for Small Business to act as a catalyst or a "lightning rod" for Cabinet-level policy development in support of SMEs.

14. Such institutional support needs to be seen as an exercise of partnership or of consultation between the Government and the private-sector, and needs obviously to involve SMEs and their organizations. This will ensure that (i) the organization of support services is market-based, i.e. they complement or encourage, rather than duplicate, private-sector initiatives or services and, where appropriate, compensate for market deficiencies and thus help to enhance the availability and effective utilization of essential inputs for SMEs, such as finance, physical facilities and equipment, training, market information, business advice, export marketing tools and business software packages; (ii) it can encourage, support or facilitate inter-firm cooperation, including in the context of industrial districts and of subcontracting arrangements with foreign firms, so as to increase the skills, flexible specialization, technological capacity, production and trading opportunities of SMEs; and (iii) it gets adequate feedback from the private-sector and SMEs concerning the effects of the framework and market conditions on business activities and possible improvements.

15. Such institutional support is normally located in a lead support agency, under the executive leadership of representatives of both the public and private sectors. However, in some countries, many of the support services are provided by private institutions, such as SEBRAE in Brazil. Coordination of the lead agency's activities with those of specialized institutions - such as in the areas of automation applications, science and technology, information technology, productivity improvement and standards and industrial research - will help to ensure a coordinated or integrated approach to assistance. For example, financial assistance for the purchase of equipment will need to be integrated with technical support for the operation of the equipment, where needed, if assistance is to be effective. In the United Kingdom, the Business Links programme integrates a wide variety of services, ranging from business consultancy to export services, in one-stop centres.

16. In the light of the above, the areas of policy development where technical cooperation may be strengthened may include (i) the policy and commercial framework for business development, with particular reference to SME development; and (ii) institutional support for SME development.

17. Technical cooperation concerning the policy and commercial framework for business development with particular reference to SMEs may take the form of providing to individual countries policy advice or technical expertise in various areas, including, for example, the formulation of proactive policies for SME development or of consistent business laws. It may also take the form of helping individual countries to build up their analytical and research capacity, either in support agencies or in business organizations, to analyse, for example, the causes of market failures, the effects of macroeconomic policies on SMEs, the effectiveness of various types of incentives in relation to their objectives or the impact of business laws and regulations on entrepreneurial and business development, including in the informal sector, as well as to determine modalities for improvement. With regard to the regulatory framework, it may be noted that Norway, for example, has established a Business Legislation Committee for the purpose of analysing the impact of business regulations on market and enterprise development. In addition to strengthening public-sector capacities for policy formulation and implementation, technical cooperation in this area may also be extended to deepening indigenous business management skills and promoting the organizational development of private-sector intermediaries (3).

18. Technical cooperation concerning institutional support for SME development may take the form of contributing to institution building, including support for the establishment of effective support agencies or SME associations, through inter alia training programmes for capacity building and support for networking, including the provision of equipment, in order to allow support agencies or SME associations in recipient countries to link up with counterparts in donor or other countries for the purpose of sharing information, experiences, lessons learned and "best practices" in the area of support for SME development. Donors can also help in the process of a constructive and collaborative policy dialogue between the public and private sectors, through their own contacts and their support for the development of representative business organizations, including SME associations (4).

19. Donors recognize that differentiated approaches may be needed for different categories of countries. As indicated in a report of the Development Assistance Committee, "Middle-income countries in general have well-established private sectors and the basic institutions and markets for producing and selling goods and services. The role will often be to support business-to-business linkages (i.e. transferring capital, technology and management and marketing know-how) and the creation of business networks. Nevertheless, it will be important for donors to continue building local and institutional and technical capacities and helping to create a more favourable environment for initiative and investment in these middle-income countries. Least developed countries, which have fewer and weaker institutions - markets and entrepreneurs and more destabilizing factors, need assistance targeted at improving the enabling environment, strengthening institutions and establishing threshold conditions for business. Countries of the former Soviet bloc present altogether different needs and opportunities: while production skills and basic infrastructure exist, capital is scarce, marketing know-how is lacking, industry is often unable to penetrate and compete on international markets. Further, attitudes and habits more conducive to private enterprise (i.e. risk taking, the concept of private property, the profit motive) are slow to develop." (5).

II. Networking and modernization of SMEs

20. Networking can take place at two levels, that of the firm and that of institutions such as SME support agencies or SME associations. In the current context, inter-firm linkages -- through joint ventures, subcontracting, franchising, establishment of alliances or of cooperative arrangements, both at home and abroad -- are an essential part of the process of modernization of SMEs. They enable SMEs to acquire knowledge of consumer preferences in their export markets, of the workings of the international market place and of the nature of international production and competition. The experience and knowledge gained allow them to adjust, for example by achieving flexible specialization, by improving design and quality, by upgrading technology and by sharing assets or undertaking joint activities in order to achieve economies of scale so as to maintain niche markets or to remain competitive. The role of inter-firm cooperation in industrial districts as, for example, in Brazil, Indonesia and Italy, is also of significant importance in contributing to the achievement of flexible specialization and the modernization of SMEs, as well as to export development.

21. Some donor programmes help to promote inter-firm linkages between domestic firms and firms in developing countries. One example is the Indo-German Export Promotion Project supported by GTZ, the German technical cooperation agency, which helps to build up closer cooperation and supplier relationships between Indian and German firms, not only in traditional sectors like shoes, silk garments, leather goods and gold jewellery, but also in technology-intensive products such as computer software, automobile and bicycle components and castings. Such linkages help Indian firms to establish themselves in German markets and, by exposing them to competitors, export marketing requirements and techniques and new market conditions, including latest information about designs and trends provided by their German partners, also encourage them to embark on new processes and activities, as well as to improve their performance and competitiveness. Further, by maintaining an economic policy dialogue with official policy-makers, the project can contribute to improving the policy and regulatory environment for Indian exporters. By working directly with firms which provide feedback to Governmental institutions and private-sector business organizations, and by indicating what types of export promotion activities are appropriate or possible, the project can contribute towards a bottom-up approach to institution building (6).

22. However, much more can be done in order to encourage SMEs to link up with other firms, either domestically or abroad. There is also a need to encourage SMEs to develop export markets or to branch out abroad. In this regard, the lack of information in a number of areas would seem to be a major factor in inhibiting the development of export markets by SMEs and the growth of their linkages with foreign firms. The areas where information is often lacking for SMEs include: sources and conditions of finance, including export finance; export market conditions, including information on design, quality, packaging and labelling requirements; marketing requirements and distribution networks; patents, trademarks and franchising regulations; subcontracting possibilities; training programmes; modern management techniques; sources and conditions of consultancy services; and calendar of future national and international events, such as trade fairs and exhibitions. SMEs have a particular need for such information, especially about export markets. Unlike large enterprises, they do no have the means to collect information by organizing their own market intelligence networks in foreign countries.

23. The availability of support in the way of timely and relevant information on export market conditions in individual countries, as well as credit facilities, including credit guarantees, training programmes and export advisory and technical services, can make a critical difference in overcoming constraints or in creating confidence, particularly for those new to the business of exporting or of branching out abroad. Examples of various services provided to help exporting SMEs include: in Japan, an Export Financing Loan Guarantee scheme for SMEs to ensure that they have access to export financing services and export insurance; in Canada, the First Time Exporter's Programme designed to help first-time exporters to set up an export business, a Cross-border Export Training Programme and a database service listing companies and products; in Norway, the Export Manager for Hire Programme under which a consultant is provided to a company to help it set up its export business, the Commercial Network Programme, designed to create alliances or networks among SMEs in such areas as export activities, purchasing and R&D, and a programme designed to provide loans to partially meet the cost of establishing SME sales subsidiaries abroad; and in the United Kingdom, the Business Link Network designed to establish a national network of one-stop centres to provide an integrated package of services to SMEs, including exporters. Various other countries, including China, France, Germany and Mauritius, have also established export information and advisory services to SMEs. The organization of trade fairs, often in cooperation with private-sector organizations, provides a highly-valued service to SME exporters, allowing them to come into contact with potential customers and business partners.

24. In the developed countries, various types of institutions have been established, aimed at promoting the internationalization of their SMEs, particularly to developing countries. The types of institutions involved and the different services provided by them are described briefly in an earlier document on the role of SMEs in export development submitted to the first session of the Ad Hoc Working Group (7). Likewise, the activities of the International Trade Centre UNCTAD/GATT in contributing to export development of SMEs are briefly described in that document (8).

25. Where firms succeed in establishing linkages with other firms, whether domestic or foreign, the channels provided by such linkages can often become the most important source of information and assistance to SME exporters. In Japan, a number of large trading companies, which have established their own market intelligence networks abroad, have played an important role in fostering the development of SME exporters.

26. In addition, networking can be established at the level of institutions such as SME support agencies or SME associations. This kind of networking can help to promote the development of inter-firm linkages and thus contribute to the development and modernization of SMEs, including exporting SMEs. An example of networking of institutions is TECHNONET Asia, which groups together 14 participating organizations -- principally SME support agencies -- from 12 countries in Asia and the Pacific. Its programmes are primarily supported by international and bilateral donors and focus on four main areas: dissemmination of industrial information; provision of industrial extension services; facilitation of technology transfer or sharing; and development of indigenous entrepreneurs and enterprises. It may be noted that SEBRAE, a private SME support agency in Brazil, is building up links in the MERCOSUR region, which allow the support agency to provide its various services to SME exporters and importers, as well as to bring them together, within the region.

27. The EMPRETEC programme, a United Nations programme managed by UNCTAD in cooperation with DDSMS in New York, which is designed to detect entrepreneurial talent and foster its development, has evolved to a stage where a process of networking and business links between the African and Latin American regions is emerging. Furthermore, UNCTAD's Global Trade Point Network allows SMEs to benefit from direct access to trade-related information (on products, markets, prices, but also on regulations and statistics for example) and to expand their activities in international markets.

28. The establishment of a network of SME agencies in ASEAN countries is, in fact, an important feature of the ASEAN Programme of Action on SME Development. Such a network will provide a mechanism to exchange information and to pool resources and expertise for SME development in the region. A number of areas for cooperation are envisaged, including policy analysis, including of SME policies and practices in order to draw lessons learned from SME support programmes and to identify "best practices"; finance, such as the possibility of establishing new financing mechanisms, including on a regional basis, for SME development; human resources development, including joint training programmes to upgrade the capabilities of entrepreneurs, managers and technical workers; technology, including sharing of information on technology and experience in the transfer of technology, as well as joint technological development in particular industries; and marketing, including cooperation in marketing and in collective promotion efforts in the form of joint trade exhibitions for particular products. The objective of such cooperation is to contribute to the modernization and rationalization of the SME sector and the strengthening of inter-firm linkages, including between SMEs and large enterprises, as part of the process of industrial deepening and of increasing the manufacturing value added in the region.

29. Likewise, proposals are under consideration for cooperation on SME development in APEC that will address a number of issues, including human resources development (APEC Centre for Technology Exchange and Training for SMEs, networking of SME-related HRD initiatives); access to information (private/business sector networking, EDI and electronic commerce); technology and technology sharing (APEC Technomart, networking among SME promotion organizations related to technology); and finance (APEC Venture Capital Workshop, investment scheme to facilitate the globalization of SMEs in the region) (9).

30. In the light of the above, the areas of policy development where technical cooperation may be strengthened may include (i) promotion of inter-firm linkages and the modernization of SMEs; and (ii) regional cooperation on SME development.

31. As regards the promotion of inter-firm linkages and the modernization of SMEs, donors may help to build up a framework for fostering inter-firm cooperation between their domestic firms and firms in developing and other countries that will encourage the latter to improve their performance so as to be able to compete successfully in international markets, while providing feedback that can help to improve the policy and commercial framework, as well as institutional support, for SME development in the recipient countries (see para. 21 above).

32. Donors can also contribute to regional cooperation on SME development by providing support for the development and networking of SME support agencies, as well as in particular

areas of regional cooperation such as policy analysis and human resources development. In addition, as stated in the above-mentioned report of the Development Assistance Committee, "more innovative mechanisms for promoting regional enterprise development through networks for mutual learning and technological capacity building could be researched and collectively supported by the donor community: such an approach could be an effective way of building regional capabilities to satisfy regional and world markets" (10).

III. Concluding observations

33. In the above discussion, four broad areas for policy development supportive of SMEs have been identified in which technical cooperation may be strengthened. These include (i) the policy and commercial framework for enterprise development, with particular reference to SMEs; (ii) institutional support for SME development; (iii) promotion of inter-firm linkages and the modernization of SMEs; and (iv) regional cooperation on SME development.

34. Such technical cooperation may involve bilateral donors or international organizations. In the case of the latter, it is recognized that there are other organizations of the United Nations system, such as the ILO, UNIDO, the World Bank, UNDP and ITC, which have programmes on SME development and which may wish to brief the Ad Hoc Working Group on their activities. Representatives of ITC and UNIDO have in fact done so at the first session of the Ad Hoc Working Group. Some aspects of UNCTAD's own activities are briefly mentioned (see paragraph 27), and some additional activities may need to be developed in the areas mentioned in paragraph 33 above, in the light of the consideration of these matters by the Ad Hoc Working Group and at UNCTAD IX. In this context, efforts will have to be made to ensure the necessary coordination in meeting the needs of member States.

Notes

1. Employment performance. McKinsey Global Institute. Quoted in: Financial Times, 18 November 1994.

2. See: ECE: "Small and Medium-sized Enterprises in the ECE Region." (TRADE/R.586). Geneva 1992.

3. See Development Assistance Committee: DAC Orientations for Development Cooperation in Support of Private Sector Development. (Paris 1994), p. 13.

4. Ibid., p.16.

5. Ibid., p. 15.

6. Optiz, St., " Export promotion in the context of technical cooperation," in Intereconomics, Vol. 29, No. 3, (Hamburg 1994), p. 139.

7. UNCTAD "The role of small and medium-sized enterprises in export development" (TD/B/WG.7/3), p. 14.

8. Ibid., p. 30.

9. See APEC Small and Medium Enterprise Ministerial Meeting, (Osaka, Japan, 22-23 October 1994), Joint Statement.

10. See Development Assistance Committee, op. cit., p. 28.